Summary

The U.S. Federal Reserve raised rates again to the degree expected, in efforts to combat inflation. Economic results for the week included mixed housing data, with sharply higher starts coupled with weaker homebuilder sentiment. The index of leading economic indicators continued to fall, reaching an important recession warning signal.

Global equity markets fell back on the week, as rising central bank policy rates fueled fears the economy will 'break' and tip into recession. Bonds declined as well, with yields ticking up across the maturity curve to multi-year highs. Commodities fell back broadly upon the same recession fears and more direct concerns of lower demand.

Economic Notes

(0) The 0.75% **FOMC** rate hike and hawkish language provided clues about their ongoing direction, although they remained noncommittal about the pace of future hikes. In the post-meeting press conference, Fed chair Powell was consistent in noting that getting back to price stability is unquestionably the most important priority, and will 'keep at it until the job is done' (echoing former Fed Chair Paul Volcker's autobiography title which reportedly sits on his desk), with inflation being a destabilizing force undermines any other pillar of the economy. Again, he reiterated that this could require some 'pain' in the near-term, including below-trend growth and labor market softening, with the only thing worse being having to come back and fight another inflation battle down the road. Specifically, he noted that the housing market needs a better alignment of supply and demand, which may require a correction in the interim. When asked about a potential ending point, he expressed a preference for wanting to see positive real rates across the yield curve (with forward-looking inflation measures being the critical variable).

Financial markets seem to be beginning to understand the Fed's level of dedication to the inflation-fighting task, after several Fed administrations offered false starts and continued dovish policies after the financial crisis. Volcker had described controlling inflation as more like a dimmer switch than an on-off function. The published 'dot plot' is somewhat useful in assessing where things stand today, but the longer-term expectations have usually been revised significantly as committee composition changes, so shouldn't be relied upon too heavily.

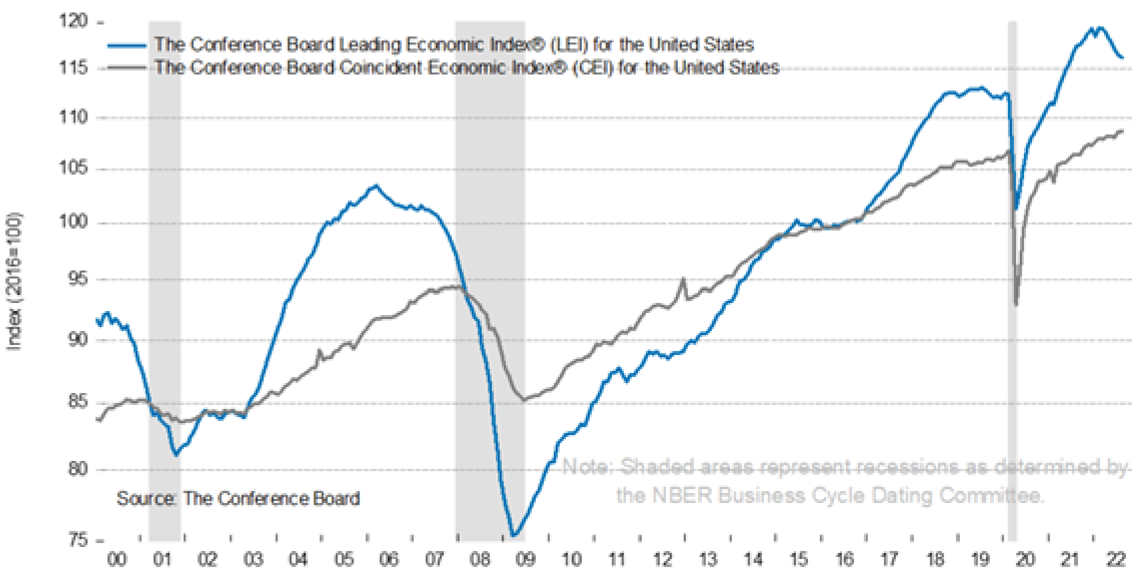
From a very long-term view, though, there are other problems with rates rising too high too fast. Recession risk aside, the biggest of these is the $30 trillion in total Federal debt. At a 1% financing rate, interest cost is $300 bil./yr., while a move to 4% raises this to $1.2 tril./yr., which begins to take on a substantial piece of the budget pie, and crowds out other spending obligations. In a secular trend of slower growth, this becomes even more of a burden. While officials and many economists don't expect rates to climb without limit, these other considerations may keep a cap on what level rates can practically reach.

(0/-) **Existing home sales** in August fell by -0.4% to a seasonally-adjusted annualized rate of 4.80 mil. units, representing the 7th straight month of declines. These results were actually better than the -2.3% median forecast, as well as July's -5% drop. Single-family sales fell back by -1%, while the smaller condos/co-op group rose 4%. Regionally, the Northeast and West saw gains over a percent, while the Midwest fell -3%. Over the past year, sales are down -20%. The months' supply of existing homes ticked up to 3.2, improving inventories. The median sales price declined by -1.7% to $389,500, the third straight monthly decline, which brought the year-over-year rate of increase down to 7.7%. Fed chair Powell noted specifically of the need for a 'reset' of the housing market, at both last month and this month's FOMC press conferences, to eliminate froth and other imbalances between incomes and home prices.

(+) **Housing starts** rose 12.2% in August to a seasonally-adjusted average annualized rate of 1.575 mil., reversing the downturn of the prior month, and well above the median forecast calling for 0.3%. While single-family starts rose over 3%, which was the first increase in six months, multi-family led the way, with a gain of 28% (a 36-year high). Overall, starts are down -0.1% from 12 months ago on net, which includes the mixed results of multi-family up 33% and single-family down -15%. **Building permits**, on the other hand, fell by -10.0% to a seasonally-adjusted annual rate of 1.514 mil., with single-family permits down -4% and multi-family correcting back by -18%. To no surprise, rising rents during the pandemic incented the building of rental properties, which tend to be financed by more leverage than single-family activity, where construction has progressed at a more tempered pace (in fact, not fast enough to keep home prices contained).

(-) The **NAHB housing market index** fell by -3 points to 46, a point below the 47 level expected—representing the 9th straight month of declines. Within the details, current sales fell -3 points, while prospective buyer traffic and future sales each fell by a point each, although the latter two are down to 2012 levels. The West saw the more significant decline, down -8 points, followed by the South, down -3 points. Obviously, the movement of 30-year mortgage rates above the 6% level has sharply challenged consumer sentiment and raised concern over forward-looking prospects.

(-) The Conference Board's **Index of Leading Economic Indicators** for August fell by -0.3%, continuing six straight months of declines. The index fell -2.7% over the trailing 6 mo. (Feb.-Aug. 2022), which was in the opposite direction of the prior 6 mo., which had experienced 1.7% growth. On the other hand, the coincident index rose 0.1% and lagging index gained 0.7%. Per the Conference Board, recent data was negative for nearly all segments, except for the positive contribution of jobless claims. Moreover, the indicator has now signaled potential recession in coming quarters, based on historical relationships between data changes and timing of downturns.



(0/+) **Initial jobless claims** for the Sep. 17 ending week rose by 5k to 213k, below the 217k level expected. **Continuing claims** for the Sep. 10 week fell by -22k to 1.379 mil., well below the 1.418 mil. expected. By state, initial claims remained mixed, with declines in CA and IN, while MI, MA, and NY saw the largest increases. Otherwise, little has changed on net from currently still-strong levels.

Market Notes

Period ending 9/23/2022	**1 Week (%)**	**YTD (%)**
DJIA	-4.00	-17.30
S&P 500	-4.63	-21.61
NASDAQ	-5.06	-30.13
Russell 2000	-6.58	-24.48
MSCI-EAFE	-5.60	-26.10
MSCI-EM	-4.03	-24.70
Bloomberg U.S. Aggregate	-1.56	-13.75

U.S. Treasury Yields	**3 Mo.**	**2 Yr.**	**5 Yr.**	**10 Yr.**	**30 Yr.**
12/31/2021	0.06	0.73	1.26	1.52	1.90
9/16/2022	3.20	3.85	3.62	3.45	3.52
9/23/2022	3.24	4.20	3.96	3.69	3.61

U.S. stocks were mixed early in the week, with investors anticipating the Wed. FOMC meeting. However, a disappointing report from Ford caused the market to negatively react to potentially more difficult conditions to come, similar to FedEx the prior week. The Fed meeting itself, the hawkish dot plot, and press conference caused several back-and-forth swings in market sentiment before declining further late in the week, as markets assumed ongoing rate hikes would indeed 'break' the economy, pushing it into recession. Several well-watched Wall Street strategists downgraded market expectations for the rest of the year, which further soured market sentiment. Every sector lost ground, led by energy and consumer discretionary, which were down 7-9%. The usual defensive sectors, utilities, staples, and healthcare, on the other hand, fell lesser 2-3%. Real estate was down -6% with the headwind of higher interest rates, which continue to challenge financing costs.

Relative to the Jan. 3 peak, the S&P 500 initially troughed at -23% on June 16, before rebounding sharply through mid-August. Now, it's fallen back to nearly the same place, which could prove to be an important technical level. It's worth a reminder that historical pre-recession bear markets, at least in the modern era, experienced a median peak-to-trough decline of around -25% to -30%. (By median, this implies some bears were less severe and a few more severe, always causing concerns that the current bear is an especially 'bad' one. However, those worse than -30% tend to be more of the structural variety, or associated with sharply overheated asset or credit levels.

Foreign stocks underperformed U.S. equities, with a sharply stronger dollar (+3%) acting as a headwind. Europe and the U.K., most heavily affected by Russian rhetoric and winter natural gas concerns, lagged Japan and the emerging markets. The Bank of England raised rates by 0.50%, as did the Swiss by 0.75%—the latter being its largest hike ever, and ending nearly a decade of negative interest rates. Following a stretch of very strong weakness in the yen, Japanese officials have publicly discussed foreign exchange interventions to boost its value for the first time in decades. This weakness have been the result of a stronger U.S. dollar, as well as compared to other currencies, as Japan remains the sole major central bank that hasn't begun a rate-hiking regime. Higher rates tend to result in stronger currencies, and given the limited levers a government has available, one lever usually has to give, and it's often the currency value, as that has a more subtle effect on domestic consumers. Interestingly, the Brazilian central bank elected to keep policy rates unchanged (at 13.75%), and noted the rate-hiking regime is over—which caused the Brazilian stock market to rally, in contrast to all others.

U.S. bonds fell back in keeping with rising interest rates across the curve, although the impact on the longer end was possibly less dramatic than some expected considering the Fed's hawkish language. Corporates underperformed treasuries a bit, due to the impact of widening credit spreads. Foreign bonds fell back, especially in developed markets, due to the impact of the stronger dollar.

Technically, after a few false starts, the 10-year treasury yield rose above 3.5% for the first time in over a decade, in advance of the Fed hike, and fueled by Sweden's rate hike by a full 1%. However, the Fed's actual decision didn't move the needle as much after that. When looked at in context of 10y-2y yields, the treasury curve inversion has continued to widen (by -0.50%), which has correlated to rising expectations of recession. The more near-term relevant 10y-3m signal has not yet inverted, but the Fed move last week makes this a foregone conclusion in coming weeks.

Commodities fell back generally, led by declines in energy and metals, due to increasing recession fears in keeping with higher interest rates and a strong U.S. dollar (which tends to have an inverse relationship with commodity prices). Crude oil fell by over -7% to just under $79/barrel, with natural gas down -10%. Oil prices also appeared to be pulled down by an extension of releases from the U.S. Strategic Petroleum Reserve. After a steep drop earlier in the year, following little change at all in 2021, the copper/gold ratio has begun to improve, in a piece of positive news. Historically, this has been seen as a bit of an early indicator of improved economic optimism (and improved equity market returns when in the lowest range, as is the case currently).

Have a good week.

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Sources: FocusPoint Solutions, American Association for Individual Investors (AAII), Associated Press, Barclays Capital, Bloomberg, Citigroup, Deutsche Bank, FactSet, Financial Times, First Trust, Goldman Sachs, Invesco, JPMorgan Asset Management, Marketfield Asset Management, Morgan Stanley, MSCI, Morningstar, Northern Trust, PIMCO, Standard & Poor's, StockCharts.com, The Conference Board, Thomson Reuters, T. Rowe Price, U.S. Bureau of Economic Analysis, U.S. Federal Reserve, Wall Street Journal, The Washington Post. Index performance is shown as total return, which includes dividends. Performance for the MSCI-EAFE and MSCI-EM indexes is quoted in U.S. Dollar investor terms.

Notes key: (+) positive/encouraging development, (0) neutral/inconclusive/no net effect, (-) negative/discouraging development.